



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: DEC 21 2002

NO PROTEST RECEIVED
Release to Manager, EO Determinations - Cincinnati

SURY

DE DATE: 3-25-2013

SURNAME

03/26/03

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated on [REDACTED], as a not-for-profit corporation under the laws of the State of [REDACTED]. According to your Articles of Incorporation, your purposes include: (1) to arrange for or otherwise facilitate the delivery of health care services by members of the corporation to employer groups and to enrollees of various health insurance or health benefit plans; (2) to engage in planning activities for your members in a manner that benefits the communities served by your members; (3) to support the advancement of and knowledge and practice of comprehensive, cost-effective health care for members of the communities served by members of this corporation; (4) to develop and promote services and programs which address the needs of the communities served for behavioral and physical health care and vocational and rehabilitative services and (5) to increase public access to high quality behavioral and physical health care and vocational and rehabilitative services by encouraging and aiding in the establishment of effective and efficient alternative delivery systems for such services.

You have stated upon receiving a favorable ruling from the Internal Revenue Service concerning your tax-exempt status, you will pursue financial support via foundations and governmental entities for your member organizations, a group of unrelated behavioral healthcare service providers which are exempt under section 501(c)(3) of the Code. You have stated that you have two Class A members who control you and six Class B members.

Section 501(c)(3) of the Internal revenue Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) of the code.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court stated that "the presence of a single...[nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly...[exempt] purposes."

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second), Trusts, sec. 368 and sec. 372; IV Scott on Trusts (3d ed. 1967), sec. 368 and sec. 372; and Rev. Rul. 69-545, 1969-2 C.B. 117.

Section 501(e) of the Code provides that a cooperative hospital service organization is treated as if it were exempt under section 501(c)(3) if it performs certain specific service activities enumerated in the statute for two or more exempt hospitals and allocates or pays, within 8-1/2 months after the end of the year, all net earnings to its members on the basis of the services performed for them.

Section 1.501(e)-1 of the regulations provides that section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization.

In HCSC-Laundry v. U.S., 450 U.S. 1 (1981), the Supreme Court held that a cooperative laundry organization that served exempt organizations could not qualify as exempt under section 501(c)(3) because laundry services is not one of the activities enumerated in section 501(e).

Section 1.502-1(b) of the regulations provides that a subsidiary organization of a tax exempt organization may be exempt on the ground that the activities of the subsidiary are an integral part of the exempt activities of the parent organization. However, the subsidiary is not

exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business if regularly carried on by the parent organization.

Rev. Rul. 54-305, 1954-2 C.B. 127, describes an organization whose primary purpose is the operation and maintenance of a purchasing agency for the benefit of its otherwise unrelated members who are exempt as charitable organizations. The ruling held that the organization did not qualify under section 101(6) of the Code (the predecessor to section 501(c)(3)) because its activities consisted primarily of the purchase of supplies and the performance of other related services. The ruling stated that such activities cannot in themselves be termed charitable, but are ordinary business activities.

Rev. Rul. 72-369, 1972-3 C.B. 245, describes an organization formed to provide management and consulting services at cost to unrelated exempt organizations. The ruling stated: "An organization is not exempt merely because its operations are not conducted for the purposes of producing a profit...providing managerial and consulting services for a fee is a trade or business ordinarily carried on for profit."

To qualify for exemption under section 501(c)(3) of the Code, an organization must be organized and operated exclusively for an exempt purpose. Your stated purposes and proposed activities, as described above, provide that you will engage in the provision of administrative services for a group of unrelated tax-exempt healthcare providers. While the promotion of health is considered a charitable purpose within the meaning of section 501(c)(3) of the Code, providing administrative services to unrelated charitable organizations does not directly promote health. There is no broad community benefit that results from such services. Providing these services is not a charitable activity but rather an ordinary commercial activity. (See above citations.) Therefore you are neither organized nor operated exclusively for charitable purposes under section 1.501(c)(3)-1(b) and 1.501(c)(3)-1(c)(1) of the regulations.

Under section 1.502-1(b) of the regulations, one organization may derive its exemption from a related organization exempt under section 501(c)(3) of the Code if it is an integral part of the exempt organization. To obtain exemption derivatively, two requirements must be met: (1) the two organizations must be "related" and (2) the subordinate entity must perform essential services for the parent. The related organization must be structurally related, not just functionally related, to be considered related for purposes of the integral part theory. Section 1.502-1(b) of the regulations includes the following example of an organization that is considered as providing essential services: a subsidiary which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities.

Under the regulations, a subsidiary organization that is engaged in an activity that would be considered an unrelated trade or business if it were regularly carried on by the exempt parent does not provide an essential service for the parent. The regulations include an example of a subsidiary organization that is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization.

Similarly, if the subsidiary were owned by several unrelated exempt organizations and operated for the purpose of furnishing electric power to each of them, it would not be exempt because the business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For this purpose, organizations are related only if they consist of a parent and one or more of its subsidiaries or subsidiaries having a common parent. An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities. See section 1.502-1(b) of the regulations.

You are controlled by [redacted] unrelated exempt organizations and operate for the purpose of providing various administrative services to your members. If any of your members regularly carried on these activities for the other members, these activities would be an unrelated trade or business. Therefore, you do not qualify for exemption under section 501(c)(3).

An organization that provides services for more than one exempt hospital, including community mental health clinics, may qualify for exemption under section 501(c)(3) if it meets the requirements of section 501(e) of the Code. However, the exemption applies only to organizations providing the services enumerated in the statute and the regulations. Since section 501(e) is the exclusive means by which a hospital service organization may qualify for exemption under section 501(c)(3) (see section 1.501(e)-1 of the regulations), a hospital service organization providing services other than those specifically enumerated in the statute does not qualify.

The various administrative services that your Articles of Incorporation enumerate and you propose to conduct for your members are not the services specifically enumerated in section 501(e) of the Code. Furthermore, you do not meet the requirements of section 501(e)(2) regarding allocation or payment of net earnings. Therefore, under section 501(e), you do not qualify as an organization that is treated as exempt under section 501(c)(3).

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or

[REDACTED]

the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service

[REDACTED]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) [REDACTED]

[REDACTED]
Manager, Exempt Organizations
Technical Group 1

cc: [REDACTED]

[REDACTED]

12-26-2002

1/2/27/02